

**MINUTES OF FEBRUARY 21, 2008, RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS
PENSION PLAN
DUE DILLIGENCE MEETING**

PRESENT

<u>Members</u>	<u>Others</u>
Michael Cross, Chair	Chuck Arrington, Trusco
Michele Evans	Carl Beveridge, Suntrust
Pat Evans	Steven Bland, Retirement Administrator
Henry Howard	Rich Dahab, Dahab Associates
Mark Jinks	Arthur Lynch, Retirement Specialist
Bruce Johnson (Alternate)	Theresa Nugent, Communications specialist
Chris Lockwood	Lisa Powell, Prudential
Shirl Mammarella	Michael Sahakian, Suntrust
Albert Tierney	Ken Verzella, Prudential
Laura Triggs	

CALL TO ORDER

The meeting was called to order at 8:39 a.m. on February 21, 2008.

MINUTES

Mr. Jinks made a motion, seconded by Mr. Howard, to approve the January 7, 2008 minutes. Staff mentioned the draft minutes distributed via email a week following the January meeting had an error. The members serving on the committees were inaccurately recorded. The error was corrected in the minutes distributed in the Board packet. The motion was unanimously approved (7-0). Mr. Evans voted in Mr. Lockwood's absence. Ms. Mammarella voted in Mr. Milner's absence. Mr. Johnson voted in Ms. Evan's absence.

Ms. Evans arrived at 8:46 a.m.

FINANCIAL REVIEW

ACTUARIAL ASSUMPTIONS

Staff distributed a handout on actuarial assumptions, Impact of Salary & Investment Assumption (labeled 3a). The focus was the "Investment spread" – the difference between the investment

return and salary growth. Sometimes the prospect of low investment returns will result in plans adjusting their asset allocation to address a potential shortfall. However, if low salary increases and low Cost of Living Adjustments are accompanied by less than the expected investment return then the actuarial gains and losses may be offsetting. An unintended consequence is a plan may end up increasing its risk profile. Mr. Jinks clarified to emphasize staff's comments were on salary inflation as opposed to general inflation. He further noted we might be entering a period of stagflation as opposed to inflation. Staff agreed.

FINANCIAL AND ECONOMIC OVERVIEW

Mr. Dahab discussed the sub-prime lending crisis, the causes and consequences to the financial industry and the economy. He discussed the proliferation of no documentation loans and low or no down payment loans. These loans were then packaged as collateralized mortgage obligations (CMO) or Collateralized Debt Obligations (CDO). The collateralized securities were then rated AAA and leveraged by allowing loans for up to six times the amount of the underlying collateral. As the value of the collateral is written down then the amount of available funds for loans shrinks. Top quality firms can still borrow money. However, profitable but average or marginal companies are having their funding sources dry up. This is a bigger threat to the economy than the more publicized mortgage foreclosures. The most challenged companies in this environment would be private equity and retailers.

Mr. Tierney arrived at 8:54 a.m.

Ms. Mammarella asked how we might get out of this situation. Mr. Dahab suggested the Comptroller of Currency might change regulations and change the six to one reserve ratio to seven to one and thereby allow more loans with a given amount of equity.

Mr. Dahab believes the current investment environment is most like 1976-1977 when there was an oil shock, post war costs were mounting, and bond prices dropped as interest rates rose. By late 2008 he expects higher interest rates, commodity, and equity prices.

Mr. Johnson asked if things were all doom and gloom? Mr. Dahab believes most of the bad news was out there. Mr. Johnson asked if Mr. Dahab expected a short painful correction or a long slow correction. Mr. Dahab expects a short & painful recovery. He believes there is still a little more bad news yet to be made public.

Mr. Dahab referred to page 1 of his quarterly report. This is the second longest expansion ever. It has been fueled by cheap credit. The biggest spoiler is \$100/barrel oil. International equities have been hurt only half as much as U.S. equities.

INVESTMENT REVIEW – Disability (DAHAB & Trusco)

Mr. Dahab began the Trusco review by acknowledging their record of out-performing the benchmark for three and five year periods. Bonds also outperformed recently. Equities underperformed for two quarters. Staff sought to clarify the universe comparisons in the Dahab quarterly report. The equity performance is compared to other large cap core managers. The fixed income comparisons are to other fixed income managers. The fund comparison is to other funds, not just ones with asset allocations of 70/30 (stocks/bonds). Thus, Trusco is being compared to other funds with alternative investments and international equities, both of which have performed well recently. The recent under performance was attributable to stock selection as opposed to sector selection.

Mr. Cross asked if this suggested we should consider a different asset allocation, one with greater diversification. Mr. Dahab said yes he would like to see the fund diversify further, but that may be hard because the Disability Income Plan's fund has only \$15 million. Diversification is the only free lunch in investing. He pointed to page 10 in his report where Trusco's favorable 70% "Batting average" is displayed.

Staff asked for clarification on page 13. The growth rate is historical rather than projected.

Trusco has traditionally been a relative value manager but about a year ago began migrating towards Growth At a Reasonable Price (GARP).

Mr. Dahab's analysis was that Trusco's sector selection was adequate but recent security selection (stock picking) was poor. Historically they had both been good. He believes the bond portfolio is positioned very well for the current environment. The portfolio has no junk bonds. Mr. Arrington said bond quality had made a big difference to portfolio returns.

Mr. Sahakian discussed the bond portfolio performance. Corporate bonds now had a very wide spread Treasury bills. Seix is now buying quality corporate bonds.

Mr. Cross asked about the different fund values on page 8 and 9. One had accruals and one did not. Mr. Arrington pointed out the benchmark had changed over time and the current benchmark is the Lehman Government Corporate Aggregate A+ or better.

Mr. Arrington discussed several strategies with an emphasis on growth. He prefers to buy "Growth on sale," meaning stocks with lower price to earnings ratios as opposed to the momentum stocks which have been bid up significantly. Momentum investing is not SunTrust's style. Trusco will stay with their process and sharpen their stock selection. Healthcare investments have been a disappointment. They will add healthcare analysts.

Staff asked about style drift. Mr. Arrington said they would periodically drift from pure core to slight emphasis on value or growth. However, drifting from large cap to mid cap would be very, very limited.

INVESTMENT REVIEW – Pension Plan (Dahab & Prudential)

Mr. Dahab reviewed Prudential's performance. He began by saying this is as good as it gets. It is rare this many managers outperform their benchmarks. Only Munder's performance was average. Turner had a spectacular year.

Mr. Cross noted the plan's relative performance had moved up from the 93rd-94th percentile to 60th percentile.

Mr. Verzella discussed Prudential's performance. He believed mean reversion was evident, after many years of value stocks doing well it is growth stock's time for relative out performance. Also, the dollar has fallen significantly. Growth companies tend to have more overseas sales than value firms. The weak dollar should help growth company profits more than it will value companies.

Oppenheimer has a new manager. They have been on the watch list since May of 2007 for that reason and not performance. They tend to have slightly lower volatility than other emerging market managers, so they are expected to underperform in up markets and out perform in down markets.

Times Square is a low volatility manager that is expected to underperform in up markets and outperform in down markets.

Mr. Verzella believes the sub-prime woes hit Munder harder than most. They should do well in the current market environment. They should do well in a sideways or downward environment.

Julius Baer did well because of a 20% exposure to emerging markets.

PRISA outperformed its real estate benchmarks. He believes their goal is 9-11% annual return.

Mr. Cross identified two references to December 31, 2007 values of \$133 million and \$137 million in the Dahab and Prudential quarterly reports. Ms. Powell indicated she would research the question and report back to us.

A question was asked about employee contributions appearing rather high in the fourth quarter. The total included both the ongoing 7.5% times pensionable salary but also the transfer of Retirement Income Account balances for disabled participants electing to purchase an annuity from the retirement plan.

INVESTMENT REVIEW – Defined Contribution Plan (Dahab & Prudential)

Mr. Verzella spoke of LSV and their approach using behavioral finance. Their underperformance was due to allocating to large and mid cap stocks as opposed to entirely large cap. Mr. Dahab added they had a large position in Countrywide Financial, which was at one

point down 90%. LSV is a well-respected manager and Prudential sees their under-performance as an anomaly

T. Rowe Price is on the watch list because of a manager change.

Cooke and Biel performance was due to under weighting commodities and a position in bond insurer MBIA. Mr. Jinks pointed out the total of fund balances in Cooke & Biel was only \$39,000.

Essex's out performance was due to 30% weighting in micro caps.

Mr. Verzella mentioned small to mid cap managers sometimes struggle when their assets grow to over \$1 billion assets under management.

Wells Fargo outperformed by 2,000 basis points. Wells Fargo and Munder have different styles. They compliment each other and make a good pair.

BOARD EDUCATION

Mr. Dahab presented on asset classes. He distributed a booklet, "Asset Classes." Asset allocation is responsible for approximately 90% of investment return. Asset allocation is the Board's most important job.

Mr. Dahab believes emerging markets are becoming more efficient.

Having more asset classes makes sense. Mr. Dahab spoke of the asset classes currently available. Timber is one of his favorites because trees are always growing. Hedge Funds have little transparency and high fees. As trustees of a public plan the Board needs to stay away from hedge funds. Private equity was an option. Venture capital was highly volatile, providing huge returns sometimes and poor returns other times. High yield bonds (a.k.a. Junk) are not attractive to Mr. Dahab, providing too much risk for the expected return. International fixed income provided yield plus or minus currency change. Recently this has been a strong plus. Emerging market bonds is something that we may want to consider opportunistically. Currently we had a very small exposure to this via PIMCO. Distressed debt was something else to consider opportunistically.

Mr. Tierney asked if risk factor increased as we potentially added these alternatives to the portfolio. If added in small quantities they may actually decrease risk. In larger quantities they would indeed increase risk.

Mr. Tierney asked if we allocate funds to a new asset class where do the funds come from? How do we determine which funds are reduced or are all funds reduced proportionately? Mr. Dahab indicated that computer modeling is done to generate the most efficient allocation.

Staff asked about the mechanics of purchasing the asset classes discussed. Many were available via separate accounts, mutual funds, Electronically Traded Funds (ETF), etc. Which classes were easiest to buy? Mr. Dahab indicated Timber was the most problematic. It required extensive legal review, insurance, and so on.

Mr. Cross asked what could be done for the Disability Income Plan to improve asset allocation. Mr. Dahab indicated a minimum of \$1,000,000 for an allocation. He suggested the first additional allocation should be international equities. To really diversify the fund needs assets of about twice the Disability fund's size.

Mr. Cross asked if it would be prudent to commingle the assets of the Disability Income Plan and the Pension Plan. He asked, could funds be commingled, such as the Disability Income Plan and the Pension Plan. Mr. Jinks said that Arlington handled their pensions that way. There is concern over the legal and tax consequences of such a change.

Mr. Cross made a motion to:

Direct Mr. Dahab to work with staff to research options to improve disability asset allocation and the feasibility, desirability, and legality of this or other options to bring better investment returns.

Mr. Tierney seconded the motion.

Discussion. Ms. Mammarella asked if this was because of Trusco's fourth quarter returns. Mr. Cross indicated this was to capture the returns of other investment options.

Ms. Triggs said if the plans' lawyer needs to be involved we should amend the motion to authorize the expense.

The motion was amended to include the option of combining the pension and disability funds.

The amended motion is to:

Direct Mr. Dahab to work with staff to research ways to improve disability asset allocation and the feasibility, desirability, and legality of this or other options including combining funds and to authorize legal expenses for legal review with expenses to be taken from the pension fund.

Mr. Tierney seconded the motion.

The motion passed (8-0).

Mr. Jinks asked how long it might take to combine funds, or otherwise merge investments. Mr. Dahab and staff concurred it was too early to set a timetable.

Mr. Johnson left at 11:05 a.m.

ADMINISTRATOR'S REPORT

INTRODUCTION - Arthur Lynch, Retirement Specialist

Staff introduced Arthur Lynch as the new Retirement Specialist. Mr. Cross welcomed Mr. Lynch.

SEMINAR SCHEDULE

Staff distributed a tentative seminar schedule and requested feedback. In the absence of comments staff will proceed with the schedule. Ms. Mammarella wants staff to stress the fact the pension plan is one component of the retirement planning. Staff reported this is included in seminars and board members are encouraged to attend the seminars. Mr. Cross said the new Fire Chief (Thiel) is considering inclusion of financial training for firefighters.

Mr. Johnson returned at 11:10 a.m.

SUNTRUST – 1099 tax forms

In prior years Suntrust had distributed tax forms (1099's) with erroneous tax status. Non-taxable income was reported as taxable. Staff reported that in January Suntrust sent drafts to review prior to distribution. The tax forms were all correct.

Additionally, staff has recently been able to access SunTrust's website. Staff will use the access to provide monthly reports.

PRUDENTIAL

Annual Statements are progressing faster this year than last year. Staff has reviewed the raw data and sent Prudential data corrections. The current timetable calls for continued review by both Prudential and Pension Administration Division and mailing benefit statements in April. Ms. Evans expressed concern that a mechanism is in place to ensure everyone who is supposed to receive a statement will receive one.

The City owns DASH, the local bus company. DASH has a defined contribution plan administered by Prudential. DASH has had some administrative issues they were working on with Prudential.

Staff referred to a handout, "Frequent Trading." A participant in the Retirement Income Plan for Firefighters and Police Officers had received a notice of violating the frequent trading policy. Staff reviewed the history of the board directing Prudential to implement a Frequent Trading policy. Staff commented that the violation occurred at a time of peak volatility and at the market's low. No action was called for.

FOLLOW UP ITEMS – Board Retreat

Mr. Spera has responded to Mr. Howard's question. The City may make financial education a required training class.

FOLLOW UP ITEMS – Prior Board Meetings

Staff referenced the Follow Up Items memo but did not discuss it.

Mr. Howard left at 11:18 a.m.

Mr. Jinks left at 11:19 a.m.

Mr. Tierney discussed member education. He believes the Board needs to tell members what is their responsibility and what is the City's responsibility. Mr. Cross said this could be discussed further at the next Board meeting.

Mr. Cross referenced page handout 2e1 – the monthly investment report. He asked if there was a way to change the allocations of the deposits to facilitate rebalancing. Staff does this as contributions are wired to bi-weekly to Prudential. Staff has the ability to direct more contributions to the under allocated funds and less to the over allocated funds. Ms. Mammarella asked what happens if Staff is not around to do this. Ms. Powell mentioned Prudential monitors this.

Staff referred to handouts on Hedge Funds (2e2), Manager of the Year (2e3), Capital Market Valuations (2e4), S&P500 Index (2e5), and Sudan Notes (2f1).

Staff noted a correction in the Summary of Activity By Fund for 2008. There was a \$3.7 million purchase of Real estate in December 2007. In the December 2007 Summary of Activity by Fund report the \$3.7 million appeared in the wrong column. It was corrected in the 2008 report. Staff said the benefits paid amount in January was lower than the average monthly amount for 2007. The variance of lump sums for those exiting the DROP can obscure the steady rise in monthly benefit payouts.

Ms. Evans left at 11:25 a.m.

Staff indicated the Investment Policy Statement directs the Board to do the rebalancing. It was clarified that Prudential does not rebalance automatically. It rebalances at the board's direction.

COMMITTEE REPORTS

DISABILITY COMMITTEE

Mr. Tierney was elected chair of the committee. He reported the committee had reviewed the issue raised by our legal counsel, Ken Hoffman. The committee was not inclined to recommend any changes. Staff indicated the committee had reviewed several distributions of participants by hire age and by age of disability. Mr. Tierney mentioned the committee requested staff prepare a distribution. The committee will meet again to review this item and then may reconsider its position.

TRAINING OPPORTUNITIES COMMITTEE

The committee did not elect a chair. Staff reported for the committee. The committee recommends training at each board meeting. At Due Diligence meetings one of the investment professionals might give a talk of ten to thirty minutes. This might be Barry Bryant, Rich Dahab, Dean Molinaro, or Chuck Arrington.

Staff noted several educational opportunities for Board members including: Association of Municipal Retirement Systems of Virginia in Newport News in April, Mid Atlantic Public Employee Retirement Systems near Dulles Airport in September, and International Foundation of Employee Benefit Plans in Carlsbad, CA in June

Ms. Mammarella made a motion to:

Authorize expense reimbursement for Board members to attend any International Foundation of Employee Benefit Plan training in 2008.

Ms. Triggs seconded the motion. The motion passed (6-0).

VALUATION AND TECHNICAL CORRECTIONS COMMITTEE

Mr. Cross, chair of the committee, provided the report. Topics included a review of completed tasks: annuity purchase, amortization of the unfunded liability, actuarial assumption (salary); and remaining tasks: elections, board member resignations, Fair Labor Standards Act, DROP (definitions of dates used for death benefits during the DROP), compliance issues (PPA 2006), and withdrawal of funds from the Retirement Income Plan.

Ms. Triggs noted the plan lawyer needed to review the work of this committee and the Board should authorize legal fees be paid out of the pension plan.

Mr. Cross made a motion to:

Authorize expenses of legal fees to draft language for plan amendments for the Valuation and Technical Corrections Committee be paid from the pension fund.

Ms. Mammarella seconded the motion. The motion passed (6-0).

OLD BUSINESS

Mr. Lockwood had brought to a prior meeting a member request for Joint and Survivor options providing a 25% or 33 1/3% survivor benefit. Mr. Tierney had spoken with Mr. Lockwood and suggested only one participant may be interested in this option. The subject is tabled until the April meeting.

Mr. Tierney brought up the issue that the service credit displayed on the Prudential website is confusing. The salary information is up to date but the service credit is through the prior December 31. Staff indicated most private employers provide service credit on an annual basis, thus Prudential's processes were geared towards that end. Staff suggested that if Prudential could not update service credit monthly maybe they could re-label the titles on the benefit statements. Ms. Powell said she would look into it.

NEW BUSINESS

Mr. Milner had requested purchase of service credit be placed on the agenda. He was unable to attend the meeting. The topic is tabled until the April meeting.

NEXT MEETING

The next meeting is scheduled for April 16, in the City Council Workroom.

Mr. Cross asked that Board members make known in advance if they want an item on the agenda.

ADJOURNMENT

A motion to adjourn was made by Ms. Triggs and seconded by Mr. Johnson. The motion passed (6-0).